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SUBJECT: GOF SELLS ADDITIONAL 6.2% STAKE IN FRANCE TELECOM
TO REDUCE PUBLIC DEBT

Ref: 04 Paris 6529

SUMMARY

1. On June 7, the French government reduced its stake in the company by 6.2%, but demand was not sufficient to sell an 8% stake to the private sector as initially planned. The decision to sell France Telecom shares was one of the first government decisions under new Prime Minister Dominique De Villepin. Privatization proceeds (3.4 billion euros) will be used to reduce public debt, which is currently over one trillion euros. The sale appears to be a symbolic gesture to show government commitment to public debt reduction and continued privatization. End summary.

Government Sells a 6.2% Stake in France Telecom

2. Exactly two days after a nine-month period during which the government stuck to its commitment not to sell France Telecom's shares (reftel), Finance Minister and former chairman of France Telecom Thierry Breton announced a government decision to further reduce its stake in the company. The government planned to sell a minimum 6% stake in France Telecom or 152 million shares it held directly and indirectly through ERAP, the public establishment that manages France Telecom's capital ("capitaux propres"). Breton said that the government might sell up to 2% more if there was adequate demand for the shares. On June 7, a finance minister press communique announced that the government sold a 6.2% stake in France Telecom.

3. Shares were sold to institutional investors through an accelerated book building process. The sale was managed by Goldman Sachs, the global coordinator and joint book-runner, and BNP Paribas, Societe Generale, Deutsche Bank and ABN Amro/Rothschild. Quotation of shares was suspended during the sale. Finance Ministry staff close to Breton said that the objective was to release stocks from "overhang" risk. The price of a share in France Telecom has decreased 7.4% since January 1. France Telecom has a market value of 56.5 billion euros.

4. The government has reduced its stake in France Telecom to 34.9% (above the minimum 33% to retain a blocking minority) from 41.1%. Since September 2004, the Government stake has decreased from 42.25% (reftel) to 41.1% due to the share sales to France Telecom's employees in January 2005. Breton confirmed that the government "plans to remain a major shareholder over the medium-term."

Privatization Proceeds Will Again Be Used to Reduce Public Debt

5. The sale netted the government 3.4 billion euros, below the 3.5-4.0 billion euro government target, which had taken into account pricing related to this type of sale. The sale has driven share prices close to 22.37 euros, below the French government's target of 22.50-22.85 euros, but well above the 19.05 euro share price earned at the last GOF sale of France Telecom stock (reftel). Francois Travailleur at Dexia Securities declared: "there is a lack of visibility regarding the three-year company strategy to reduce costs and debt; the price was expensive; the environment of the sector is still weak; and we are seeing many profit warnings. People think the sale was politically motivated rather than an economic response to events demonstrating quick government action."

6. The government will use the proceeds from the partial privatization of France Telecom to reduce its public debt of 64.7% of GDP in 2004 or 1.067 trillion euros. This decision

falls under French government efforts to reduce the public debt to 62% by 2008. Yet privatization proceeds cannot be used to reduce the general government budget deficit, as EU budget rules forbid the use of privatization proceeds for this purpose.

17. So far during 2005, the government has sold shares in the state-owned toll highway company SANEF (950 billion euros) and France Telecom. Other privatization plans this year may include electricity and gas utilities EDF and GDF, as well as the nuclear group Areva. The initial public offering of GDF was expected to come to market in September, while share offerings for EDF may be postponed from October/November until early 2006. De Villepin promised that the partial privatization of Gaz de France (GDF) would begin on June 23, with sales of Electricite de France (EDF) and several highway companies to follow.

Unions Protest

18. The sale of France Telecom shares was announced late on June 4 -- a week after the French rejected the European constitution. The decision sparked an outcry from unions about employment and the future of public services. Much of the French public considers telephone, electricity and gas to be "public services" whose quality, availability, and affordability should be guaranteed to all residents by the French state. Labor union group Force Ouvriere stated: "after a slap in face on May 29 with the rejection of the European Constitution, we were expecting a government policy re-focused on public services; and we get an accelerated privatization of France Telecom: the government has not understood anything." However, unions had already called for a day-long strike on June 8 before news that the government announced it was selling a new stake in France Telecom.

Comment

19. Selling shares of France Telecom was the easiest way for Breton to reduce public debt. Planned partial privatizations of GDF and particularly EDF are much more controversial among powerful public sector labor unions. Nevertheless, the overall impact on the public debt is minuscule, as the debt remains around one trillion euros after proceeds of the sale. Some might say that the France Telecom sale is merely a symbolic move showing that the new government continues its pursuit of privatization.
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